

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 98-0085 ST

Sales And Use Tax

For Tax Period: 1994 Through 1996

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ISSUES

I. Sales & Use Tax – Product Labels

Authority: IC 6-2.5-5-3; 45 I.A.C. 2.2-5-8; 45 I.A.C. 2.2-5-14

Taxpayer protests the imposition of the sales/use tax on product labels.

II. Sales & Use Tax – Underwriters' Laboratory (UL) Labels

Authority: IC 6-2.5-5-3; 45 I.A.C. 2.2-5-8; 45 I.A.C. 2.2-5-14

Taxpayer protests the imposition of the sales/use tax on UL labels.

STATEMENT OF FACTS

Taxpayer is a manufacturer of insulation materials. Taxpayer utilizes two different types of labels that were assessed sales and use tax by the auditor. Taxpayer protests these assessments arguing the labels are used in the production process and are exempt from sales/use tax. Additional facts will be provided below, as necessary.

I. Sales & Use Tax – Product Labels

DISCUSSION

The purchase of tangible personal property is exempt from the sales/use tax if it falls within the exemptions, as provided in IC 6-2.5. Indiana Code 6-2.5-5-3 exempts transactions if the property is for the “direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.”

The auditor assessed sales/use tax on product labels affixed to the outside of the boxes in which the taxpayer’s product was transported. The auditor cited Department Regulation 45 I.A.C. 2.2-5-14 and argued the product labels did not fall within the exception provided. 45 I.A.C. 2.2-5-14 states in part:

(a) The state gross retail tax shall not apply to sales of any tangible personal property which is to be incorporated by the purchaser as a material or an integral part into tangible personal property produced for sale by such purchaser in the business of manufacturing, assembling, refining or processing...

(d) ... “Incorporated as a material or an integral part into tangible personal property for sale by such purchaser” means:

(1) That the material must be physically incorporated into and become a component of the finished product...

The auditor argued that as the product labels were placed on the container and did not become a part of the product they were not exempt by this regulation or by IC 6-2.5-5-3.

The taxpayer stresses that these were not shipping labels. The customers’ names and addresses did not appear on the product labels. The customers did, however, require these labels because otherwise the contents of the containers would be unknown. The taxpayer urges its product would have been unmarketable without the product labels. Taxpayer claims it produced more than one thousand different types of pipe insulation alone and that all types went into one of four different cardboard containers. Without the product label attached to the outside of the container there would have been no way for the customers to know which product they had received. The labels were an integral part of the product.

Taxpayer also states the labels were attached prior to the product being placed in the containers and, therefore, the labels were incorporated before the manufacturing process ended. Taxpayer cites 45 I.A.C. 2.2-5-8(d) which states:

Pre-production and post-production activities. “Direct use in the production process” begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, *including packaging*, if required.

Emphasis added.

Taxpayer claims the product was not in its completed form until it was placed in the packaging. And the packaging was required, by the customers, to have the product labels.

Taxpayer also argues that similar labels were pre-printed on plastic bag packaging used by the taxpayer for other products and the Department determined that packaging (including the labels) was exempt from the retail sales tax. Taxpayer claims that packaging was used for the same purpose as the packaging and labels in question.

For all the above-stated reasons, the taxpayer urges that product labels were not taxable.

FINDING

Taxpayer's protest is sustained because the labels were part of the required packaging which is the final step in the taxpayer's production process.

II. Sales & Use Tax – Underwriters' Laboratory (UL) Labels

DISCUSSION

The auditor assessed sales/use tax on UL labels that were attached to the containers. The auditor distinguished between UL labels that were affixed to the product directly or included inside a clear packaging from those labels attached to the outside of the non-returnable containers.

The taxpayer points to the arguments made in Issue I and states the UL labels were an integral part of the finished product. Taxpayer claims its customers would not accept the products without the UL labels for many reasons including the customers' legal liability. Taxpayer states it did not have a marketable product prior to the UL labels being affixed, whether it be to the product directly or to the packaging. Taxpayer disputes the auditor's distinction and argues the Department is arbitrarily taxing the labels based on their placement rather than their purpose.

FINDING

Taxpayer's protest is sustained for the same reason given in the finding for Issue I.